DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: May 2, 2011
POSITION: Oppose

BILL NUMBER: AB 155
AUTHOR: C. Calderon
RELATED BILLS: AB 153,

BILL SUMMARY: Use Tax: Retailer Engaged in Business

This bill would chapter out the affiliate and long-arm nexus provisions of Chapter 7, Statutes of 2011 (AB X1 28), which was signed into law in late June. This bill would also re-enact the provision of AB X1 28 that considers any retailer that is a member of a commonly controlled group, as specified, to have nexus.

FISCAL SUMMARY

This bill would reduce state and local revenues by an estimated $117 million by chaptering out some of the provisions of AB X1 28, which was signed into law in late June. In the budget, $200 million was assumed for AB X1 28, of which $83 million was due to Amazon, which is the only known company that would fall under the controlled group of corporations nexus provision. Since this bill would re-enact that particular provision but chapter out the other provisions of AB X1 28, a $117 million revenue loss would be incurred.

COMMENTS

The Department of Finance is opposed to this bill. This bill was last amended on May 2, 2011, and, therefore, is referencing language in Section 6203 that has been subsequently changed by AB X1 28. This bill needs to be amended to reflect changes to current law. Otherwise, it would chapter out other provisions of AB X1 28 intended to expand the definition of nexus to cover a greater number of out-of-state retailers.

Analyst/Principal	Date	Program Budget Manager	Date
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Department Deputy Director	Date

Governor's Office:	By:	Date:	Position Approved_______
			Position Disapproved

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ANALYSIS

A. Programmatic Analysis

Under current law, a use tax is imposed on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The use tax is imposed on the purchaser, and unless the retailer collects the use tax, the purchaser is liable for the tax, unless the tangible personal property is specifically exempted.

Under current law, if a retailer has sufficient business presence or “nexus” in California, they are required to collect the use tax on all sales to California customers. Current law, Revenue and Taxation Code 6203, considers the following retailers to be a “retailer engaged in business in this state” and to have nexus in California:

- Any retailer maintaining, occupying, or using, permanently or temporarily, directly or indirectly, or through a subsidiary, or agent, by whatever name called, an office, place of distribution, sales or sample room or place, warehouse or storage place, or other place of business.
- Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.
- Any retailer deriving rentals from a lease of tangible personal property situated in this state.

Under current law, pursuant to AB X1 28, Revenue and Taxation Code 6203 considers the following retailers to be a “retailer engaged in business in this state” and to have nexus in California:

- Controlled Group of Corporations--Any retailer that is a member of a commonly controlled group and a member of a combined reporting group that includes another member of the retailer’s commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer.
- Affiliate Nexus--Any retailer entering into an agreement or agreements under which a person or persons in this state, for a commission or other consideration, directly or indirectly refer potential purchasers of tangible personal property to the retailer under specified conditions.
- Long-Arm--Any retailer that has substantial nexus with this state for the purposes of the commerce clause of the United States Constitution and upon whom federal law permits this state to impose a use tax collection duty (long-arm provision).

This bill would chapter out the affiliate and long-arm nexus provisions of AB X1 28, which was signed into law in late June.

This bill would re-enact the provision of AB X1 28 that specifies that any retailer that is a member of a commonly controlled group and a member of a combined reporting group that includes another member of the retailer’s commonly controlled group that, pursuant to an agreement with or in cooperation with the retailer, performs services in this state in connection with tangible personal property to be sold by the retailer, shall be considered a “retailer engaged in business in this state.”

Discussion

Finance notes that this is a highly controversial issue and several states have used various strategies to attempt to get out-of-state retailers to begin collecting sales and use tax on their sales within a given state. Under *Quill Corp. v. North Dakota*, 504 U.S. 278 (1992), the court held that compelling an out-of-state retailer to collect and remit sales taxes was a violation of the Commerce Clause.

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Since Quill, states have been legally barred from forcing retailers with no nexus to the state to collect and remit use tax on behalf of the state. However, in New York, Amazon is currently collecting use tax in that state due to legislation passed in 2008 that presumed a retailer "solicits" business in the state if an in-state entity is compensated for directly or indirectly referring customers to the retailer, thereby establishing nexus for such firms. Amazon, which is by far the largest retailer affected by this legislation, sued the New York taxation department contending that the law violated the Commerce Clause of the U.S. Constitution. Overstock subsequently joined Amazon in the suit. The New York Supreme Court dismissed the suit, though Amazon and Overstock have appealed the decision. In November 2010, the New York Court of Appeals ruled that the New York statute was constitutional on its face; however, issues of fact still remain with respect to some of Amazon's as-applied challenges and a remand was issued to the trial court to take further evidence.

Sales tax nexus legislation has been considered recently or is pending in Arizona, Arkansas, Connecticut, Hawaii, Massachusetts, Minnesota, Mississippi, New Mexico, Tennessee, Texas, Vermont, and Rhode Island (Rhode Island has a bill to repeal their existing sales tax nexus law). North Carolina, Rhode Island, Colorado, Illinois, Connecticut, and Arkansas are other states that have passed some form of sales tax nexus legislation. And California, in June 2011, signed into law ABX1 28, which included several sales tax nexus provisions, including a provision that is substantially similar to this bill.

Amazon.com LLC's commonly controlled group includes California-based members such as A9.com, which provides product and visual search technologies for the Amazon website, and Lab 126, which provides design and development services for Amazon's Kindle. Therefore, Amazon would fall under the purview of this bill. It is now known at this point what other out-of-state retailers would be affected by this bill.

In an August 2010 research report titled "FLAWED SYSTEM: ONLINE SALES TAX COLLECTION", Richard A. Parker concludes the following: "California retail establishments physically based in the State are losing $4.1 billion in sales presently (2010) to Internet retailers that would, instead, be made at stores physically located within California." While the assumptions used to reach this conclusion may or may not be aggressive, it stands to reason that an 8 percent to 9 percent price differential will have an effect on consumer's buying decisions, especially on big-ticket items such as flat-screen televisions, which are readily available and easily purchased online. Further, sales growth in online retailing has outpaced growth at brick and mortar by a significant margin in recent years and is forecast to continue to do so over the next decade. In his report, Parker further concludes that "Indirect and induced impacts brought about by these sales losses will cause a total of $7.2 billion in lost economic activity in California in 2010. This loss of economic activity in California can be expected to reach $13.4 billion by 2015, and $24.9 billion by 2020."

One of the purposes of this bill is to close the use tax gap. In late 2010, the BOE estimated that the use tax gap in this state for fiscal year 2010-11 would be $1.145 billion, of which $795 million is owed by consumers and $350 million by businesses. Finance notes that Chapter 16, Statutes of 2009 (ABX4 18) should improve compliance of use tax payments by businesses by requiring businesses with at least $100,000 in calendar-year revenue that do not sell tangible personal property to register with the BOE (prior to the Chapter, they were not required to register with the BOE). Collections in 2009-10 as a result of this legislation were quite low at around $22 million (all funds); however, this number may increase in the coming years.

After ABX1 28, which has a provision substantially similar to this bill, was signed into law, Amazon filed a petition for a referendum that will let voters decide whether to overturn the new law that would compel many online retailers to collect sales tax in California. The California Attorney General's Office has approved the petition, and Amazon has until late September to gather 504,000 signatures

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to bring its measure before Californians in the next statewide vote in February. Amazon is not currently collecting sales tax on sales of tangible personal property to California residents.

The author's office confirmed to this analyst that they still intend to move forward with this bill.

B. Fiscal Analysis

This bill would reduce state and local revenues by an estimated $117 million by chaptering out some of the provisions of Chapter 7, Statutes of 2011 (AB X1 28), which was signed into law in late June. In the budget, $200 million was assumed for AB X1 28, of which $83 million was due to Amazon, which is the only known company that would fall under the controlled group of corporations nexus provision. Since this bill would re-enact that particular provision but chapter out the other provisions of AB X1 28, a $117 million revenue loss would be incurred.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2011-2012	FC	2012-2013	FC	2013-2014	Fund Code
1149/Sale Use Tax	RV	No	U	-$57,000	U	-$62,000	U	-$67,000	0001
1148/Realign-Sale	RV	No	U	-$7,000	U	-$8,000	U	-$8,000	0331
1149/Sale Use Tax	RV	No	U	-$4,000	U	-$4,000	U	-$4,000	3059
L149/Loc Rev Sale	RV	No	U	-$49,000	U	-$53,000	U	-$57,000	0994
0860/Equalization	SO	No		------------------- No/Minor Fiscal Impact -------------------					0001

Fund Code	Title
0001	General Fund
0331	Sales Tax Account, Local Revenue Fund
0994	Other Unclassified Funds
3059	Fiscal Recovery Fund